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The *AmSouth* Litigation  
*Stone et al. v. Ritter et al.*, No. 93, 2006 (Del. Nov. 6, 2006) (*en banc*).

In *Stone v. Ritter*, the Delaware Supreme Court affirmed the Court of Chancery's dismissal<sup>1</sup> of a complaint bringing a stockholders' derivative action against fifteen current and former directors of AmSouth Bancorporation ("AmSouth"), a Delaware corporation. The claim was grounded in the fact that AmSouth had, in fact, paid some \$50 million dollars in fines and penalties in order to resolve investigations for alleged violations of the federal Bank Secrecy Act ("BSA")<sup>2</sup> and various federal anti-money laundering ("AML") regulations. In the Court of Chancery action, stockholder plaintiffs failed to make pre-suit demand on the AmSouth Board of Directors. Plaintiffs essentially brought a *Caremark*<sup>3</sup> claim, alleging that demand was futile because the board members faced a substantial likelihood of liability arising from their "sustained or systematic failure ... to exercise oversight – [*i.e.*] an utter failure [by directors] to attempt to assure a reasonable information and reporting system exists"<sup>4</sup> regarding employee compliance with the government's banking regulatory regime. Although acknowledging that in hindsight the compliance regime instituted by AmSouth proved insufficient to assure compliance with federal law, the Court of Chancery took the position that plaintiffs failed to plead "facts showing that the board was ever [subjectively] aware that AmSouth's internal controls were inadequate ... and that the board chose to do nothing about problems it allegedly knew existed,"<sup>5</sup> and therefore, held that the plaintiffs failed to adequately plead facts establishing demand futility. In other words, because plaintiffs failed to plead particularized facts tending to establish that the Board knew its controls were inadequate, *i.e.*, acted in bad faith, the directors faced no personal liability for violating their fiduciary duty as a matter of Delaware corporate law, and absent directors' facing

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<sup>1</sup> See *Stone v. Ritter*, C.A. 1570-N, 2006 WL 302558 (Del. Ch. Jan. 26, 2006) (Chandler, C.).

<sup>2</sup> See 31 U.S.C. § 5318 (2006) *et seq.* See also 31 C.F.R. § 103.18(a)(2) (anti-money laundering regulations).

<sup>3</sup> See *In re Caremark Int'l Inc. Deriv. Litig.*, 698 A.2d 959 (Del. Ch. 1996).

<sup>4</sup> *Id.* at 971.

<sup>5</sup> See *supra* note 1, at \*2.

a substantial likelihood of personal liability arising from their violating their fiduciary duty demand cannot be waived as futile. Therefore, the Court of Chancery dismissed the action for failure to comply with Court of Chancery Rule 23.1.

On appeal, the Court of Chancery's Rule 23.1 dismissal was reviewed *de novo* and affirmed by the *en banc* Court. The Court ultimately determined that the duty of good faith is not an independent fiduciary duty, but rather a component of the duty of loyalty.

The Supreme Court's affirmance was largely based on a report by KPMG Forensic Services ("KPMG"). On the same day that AmSouth settled with the U.S. Attorney's Office for the Southern District of Mississippi, other federal (and state authorities) required AmSouth to engage an independent consultant to conduct a comprehensive review of AmSouth's compliance program and to make recommendations as to future compliance. This report was incorporated by reference into plaintiffs' complaint. KPMG's report noted that AmSouth had a BSA officer who was responsible for Bank Secrecy Act and anti-money laundering matters, reporting and presenting proposed policy changes to the board and for training staff. The BSA officer was assisted by a compliance department with nineteen staff members. Furthermore, there was a corporate security department, headed by a former U.S. Secret Service agent and a suspicious activity oversight committee – having responsibilities supplementing those of the BSA officer and the compliance department. The Board's Audit Committee oversaw BSA/AML compliance program on a quarterly basis. Moreover, AmSouth's compliance assurance regime predated AmSouth's becoming aware that it was the target of any government investigation. On this basis, the Supreme Court held that the directors acted in good faith, there was no utter lack of oversight and monitoring, although the Board's compliance regime ultimately failed. The Board's members, having acted in good faith, faced no personal liability, thus pre-suit demand could not be excused and affirmance of the dismissal of the complaint was ordered. The Court stated:

In the absence of red flags, good faith and the context of oversight must be measured by the directors' actions 'to assure a reasonable information and reporting system exists' and not by second-guessing after the occurrence of employee conduct that results in an unintended adverse outcome.

*AmSouth* teaches that compliance programs of long-standing, staffed with credible persons, supported by staff, whose results are regularly monitored by an active board will likely defeat a *Caremark* challenge. Furthermore, a history of reforms being proposed to the board by corporate officers in order to update and

improve corporate compliance also creates a positive record when examined in future litigation.